Value for Money

Approach to Value for Money (VfM)

The Board recognises that it is essential that English Rural is focused on demonstrating VfM through its activities. The housing sector is facing big challenges, both in terms of delivering new supply and also maintaining high levels of services to existing residents. English Rural's business model is built on ensuring that services to existing residents are maintained at a high level and fully funded before looking to contribute any internal resources to the provision of new homes. To deliver VfM, English Rural is prepared to be innovative, be more commercial and generate economies of scale through both organic and inorganic growth. These actions will deliver greater financial capacity to invest in the Association's agreed purpose. English Rural's VfM Strategy can be summarised as the ability to effectively mobilise investment and deliver on its agreed purpose, whilst using capacity and resources more efficiently. To understand how well it does this, it is important that there are easy to measure targets and outcomes. These include both financial and non-financial, some which will be generic and comparable across the sector and others which are more specific to English Rural's overall Business Strategy.

VFM Standard

A new Value for Money (VfM) Standard, issued by the Regulator for Social Housing (RSH), came into effect from April 2018. It moved the focus of the RSH's approach away from the primarily narrative VfM Statements to reporting through the statutory annual accounts by Registered Providers (RPs) such as English Rural, on progress in meeting their own targets, including a suite of metrics to be defined, from time to time by the RSH.

The outcomes required by the new Standard are that RPs registered with the RSH must:

(a) Clearly articulate their strategic objectives;
(b) Have an approach agreed by the Board to the achievement of VfM in meeting those objectives and the demonstration of the delivery of VfM to stakeholders;
(c) Through the strategic objectives to articulate the Board's strategy for delivering homes that meet a range of needs;
(d) Ensure that optimal benefit is derived from resources and assets to secure economy, efficiency and effectiveness in the delivery of strategic objectives.

The new VfM Standard encourages RPs to provide additional measures and targets which are bespoke to the organisation and which supplement the VfM metrics. This includes measurable targets and plans to address any areas of underperformance. The Group performance figures for 2018/19 against the VfM metrics are shown below. Sector wide figures provided by the RSH are shown for comparison purposes. It should be noted that the benchmark comparisons, even though the most recently published, are two years out of date and so are not directly comparable with English Rural's figures for 2018/19.

The VfM metrics are extremely helpful in ensuring that focus continues on both improving efficiency and economy as well as on investment in both existing and new homes. This is sometimes a difficult balance to maintain, and one which was significantly impacted by the implementation of the four years of 1% rent reductions started in 2016. As with other RPs, this has put pressure on operating margins, return on capital employed and interest cover. English Rural's approach to navigating these financial pressures continues to be to grow, both through building new homes and through opportunities to work with other like-minded partners. The aim being to spread overheads and improve financial capacity to deliver more homes and services in the future.

Value for Money Metrics (Group)

Metric	English Rural 2018/19	English Rural 2017/18	Median RP's < 2,500 units	Median All RP's > 1,000 units
1 - Reinvestment %	5.5%	2.2%	4.0%	5.6%
2 - New supply delivered %:				
A. New supply delivered (Social Housing Units)	0.6%	1.6%	0.9%	1.2%
B. New supply delivered (Non-Social Housing Units)	0%	0%	0%	0%
3 - Gearing %	34.0%	32.6%	30.4%	43.4%
4 - EBITDA MRI Interest Cover (inc sales) % **	148%	183%	248%	212%
5 - Headline social housing cost per unit	£2,688	£2,326	£3,650	£3,290
6 - Operating Margin %:				
A. Operating Margin (social housing lettings only)	27.2%	32.5%	31.5%	34.7%
B. Operating Margin (overall)	25.8%	27.9%	28.0%	31.4%
7 - Return on capital employed	1.7%	2.2%	3.7%	4.3%

* Source: Regulator of Social Housing – VfM Metrics - Summary Report Sept 2018 (2017 data)
** This interest cover definition differs from that used by our funders (see page 9) as it includes surpluses from the sale of properties. Performance is, therefore, generally higher than for loan covenant purposes.

Re-investment (Efficiency) – 5.5% versus 4.0% benchmark*

This measure will fluctuate year-on-year depending on the profile of spend on both the replacement of existing capital components eg kitchens and bathrooms and also the timing of spend on new developments. Due to most of English Rural's stock being built over the last 20 years, it is only now that more significant capital component expenditure is being undertaken and this is reflected in the 2018/19 figure of 4.6%. The majority of the increase in re-investment compared to 2017/18 has been the rise in spend on a pipeline of new developments which represents 4.8% of the 5.5%. This spend profile will continue over the next four to five years, as English Rural delivers its planned 200 new homes, and re-investment will average around **6%** over this period, in-line with the median for RPs owning more than 1,000 units.

* benchmark taken as RP's under 2,500 units

New supply delivered (Effectiveness) – 0.6% versus 0.9% benchmark

As with re-investment, the percentage of new supply delivered will fluctuate year-on-year depending on the timing of completions. In 2018/19, there were fewer completions with some falling just into the first quarter of 2019/20. The forecast percentage for 2019/20 is nearer 2% and the forecast average over the next five years is **3.3%** which is significantly ahead of benchmark figures and demonstrate English Rural's commitment to use its financial capacity and deliver new affordable homes.

Gearing (Efficiency) – 34.0% versus 30.4% benchmark

Current gearing of 34% is above the median for English Rural's size and is forecast to rise to 42% over the next five years as more debt is taken on to deliver the Business Strategy. Debt per unit increases from £29k to £35k over this period. This is a manageable increase and within the Board's accepted risk tolerance. The increase is also in-line with English Rural's business plan expectations and with the median for Registered Providers owning more than 1,000 units.

EBITDA MRI Interest Cover (Efficiency) – 148% versus 248% benchmark

This metric has been directly impacted by the implementation of the four years of 1% rent reductions and also the interest cost of carrying the cash proceeds from the Affordable Homes Fund taken out in 2015. The £11.6m of funds raised have now mostly been re-invested into new affordable homes and rental income generated more than covers the interest payable. In addition, there is a programme of both shared ownership and market sales in the development pipeline which will improve interest cover. The expectation is that this measure of interest cover will start to increase and average **235%** over the next five years, more in line with the benchmarks.

Headline social housing cost per unit (Economy) - £2,688 versus £3,650 benchmark

English Rural performs well in this area and will continue to do so for the foreseeable future. As English Rural's stock has mostly been built over the last 20 years, to date there has not been the need to spend significant sums on capital replacements. This programme of replacement will start to increase over the next five years, as more kitchens and bathrooms in particular will need replacing. Average unit costs will, therefore, start to increase although are projected to remain well below the benchmark median. The increase will be partially offset by the addition of 200 new affordable homes achieved through the Business Strategy. The economies of scale achieved by this growth will have a positive impact on overall costs per unit. A new Head of Property Services was appointed in April 2019 and a key focus for this new role will be to deliver procurement savings through better management of the supply change.

Operating Margin % (Efficiency)

Social housing – 27.2% versus 31.5% benchmark

Social housing margins have been squeezed due to the 1% rent reductions affecting the majority of English Rural's stock. Increasing operating margins is a priority for the English Rural Board and an outcome expected through the new Business Strategy. This will be achieved by increasing operating surpluses through growing unit numbers, economies of scale in terms of cost control and looking at partnering opportunities to further spread overheads. Increasing core margins is essential to freeing up financial capacity and improving returns on capital employed. Margins are projected to increase to 33.4% by 2024.

Overall – 25.8% versus 27.9% benchmark

Overall margins tend to be lower as they include business activities which have lower returns. In particular income generated form third party services and development activities have much lower margins than social housing. However central overheads, which are mostly fixed, allocated to those activities help reduce the costs associated with social housing lettings and as a result improve those margins. Overall margins are projected to increase to 31.4% by 2024.

Return on capital employed (Efficiency) – 1.7% versus 3.7% benchmark

The one area where there appears to be a relative underperformance is in relation to return on capital employed (ROCE). In 2018/19 a number of factors meant that English Rural's operating surplus was lower than expected. There were some one-off cost pressures in professional fees and maintenance which had a negative impact on return on capital employed. The Association's business plan forecasts show that ROCE will average 3.0% over the next five years but remains below the current benchmark average.

Having sought to understand the reasons for this, the relatively high proportion of shared ownership properties owned has been identified as one of the main reasons. The historic model of shared ownership sold by English Rural was designed to be an affordable product in high-value rural areas. Because of this, the model charges relatively low rents on the retained shares, and consequently, secures lower returns for the Association. The impact of this reduces the overall return by circa 0.5%. In response to this, English Rural has introduced a new model and policies which look to increase the return on existing and new shared ownership properties.

Another factor contributing towards the low performance is the fact that the majority of English Rural's homes were built on rural exception sites, with build costs significantly higher than average due to the need to put in place services and access, without a corresponding increase in rent that can be charged. Only a small proportion of homes were built through Section 106 agreements, where generally costs are lower due to any subsidy being included in the purchase costs. English Rural will continue to prioritise its delivery of rural exception sites as these are important for achieving agreed purpose and business objectives. As a consequence, ROCE will likely remain below the median for the sector as a whole.

Other strategic VfM measures

Delivering value to residents through the services it provides is a key strategic aim for the Board. Key to this are the specific challenges that residents in rural areas can experience. In particular, improving the energy efficiency of properties, playing a leading and influential role within the rural housing sector and increasing resident involvement are three areas where English Rural wants to deliver more value. The table below provides measures and targets.

Value to be delivered	Target	Current position	Measures to be taken
Energy efficiency Reducing energy costs and tackling fuel poverty in rural areas to address the financial disadvantages already facing low income rural households.	That 90% of rented homes will have an EPC band rating of C or above by 2024 and all housing association stock will achieve at least EPC rating of C by 2030 Ensure all new homes developed through the Business Strategy achieve an EPC rating of at least B.	75% currently meet EPC rating of C or better.	• Complete the current retrofit programme to replace electric storage heating. • Use latest data from the Stock Condition Survey to identify and model improvements to older homes; • Actively seek beneficial grant opportunities for improving property performance; Work with residents to identify what avenues maybe available to them; Collaborate with housing association and commercial partners to secure good value; • Ensure all new build properties achieve EPC rating of at least B.

Rural advocacy To generate direct benefits for rural communities and increase the supply of affordable rural homes through influencing rural policies at regional and national level.	To increase the supply of affordable rural homes through policy influence; To work with smaller organisations through a paid for service to release otherwise dormant investment capacity into new affordable homes;	No rural housing target from Homes England and investment in affordable rural homes (settlements of less than 3,000) around 10% of AHP Actively working with three smaller providers to deliver more affordable rural homes, with a programme of 14 new homes.	• Increase in the current level of Homes England investment in affordable rural housing • Formalise and promote an offer to smaller rural providers and continue to unlock their capacity for investment in new affordable homes. • Develop a formal Communications Strategy to efficiently target resources at achieving advocacy ambitions detailed in the Business Strategy
Resident involvement Developing services to meet changing demands securing efficiencies through technology, whilst more vulnerable households.	To maintain overall satisfaction levels within the upper quartile for the sector; To launch an online resident portal; Pro-actively engage with staff to improve performance and skill base; To be more open and transparent and accountable in our service offering.	Continued good levels of overall satisfaction with services provided. No online self-service offer for residents. Updated stock condition data, but not articulated yet through a refreshed Asset Management Strategy. A sound approach to resident scrutiny, but one that could be developed in partnership with residents to be more open and accountable.	• Be an early adopter of NHF Together with Tenants; • Publish a five-year investment plan and review the Asset Management Strategy; • Launch an online offer for residents and mobilise a campaign to promote self-service, with at least 50% of residents signed-up within the first year; • Review training needs of staff improve knowledge base/skills through training; • Maintain or increase the current level of overall resident satisfaction. Support independent resident scrutiny of service performance and publish the results of this.